INDIANA
INVESTMENT WATCH

Consumer's Guide to Loan Brokers

www.IndianaInvestmentWatch.com

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HOW THE SECRETARY OF STATE CAN HELP CONSUMERS

Consumers may call Indiana Secretary of State Todd Rokita's office toll-free at **800.223.8791** to find out whether a loan broker is properly licensed with the state or is exempt from registration. This can also be checked via the Internet at **www.IndianaInvestmentWatch.com**. From this Web page, click on ***search database*** and type in the name of the loan broker. A records page will appear, indicating whether the loan broker has a current license. The Internet search, however, does not have records of exempt loan brokers. If the search returns ***no record found***, the consumer may call the Secretary of State's office at the number shown above and ask to search the loan broker database to learn whether the loan broker is exempt or not registered at all.

THIS BROCHURE IS DESIGNED TO DO THE FOLLOWING:

- Alert you to common issues in dealing with loan brokers
- Provide you with useful Web sites about the mortgage process
- Provide a checklist that will aid you in effectively using the services of a loan broker

Note:
The Loan Broker Act does not give the Secretary of State's office the authority to change the terms of any mortgage into which you entered when you signed the mortgage contract and related promissory note at the real estate closing. The written mortgage contract and related promissory note will usually prevail. You may have other remedies under federal law or state law other than the Indiana Loan Broker Act.

Loan Brokers: An Introduction

THE INDIANA LOAN BROKER ACT

Indiana Code 23-2-5

The Indiana Secretary of State, through his Securities Division, enforces the Indiana Loan Broker Act. This state law regulates loan brokers that do business in Indiana. Loan brokers, including mortgage brokers, bring together borrowers and lenders for a fee. This fee is collected at the closing of the loan. The vast majority of loan brokers doing business in Indiana are mortgage brokers. Roughly 80 percent of residential mortgage loans are now originated through loan brokers. Most loan brokers represent anywhere from 10 to 70 different lenders. Each of these lenders makes loans on different terms and uses different underwriting guidelines.

Many loan brokers are honest professionals who provide a valuable service to borrowers. However, as in any industry, some loan brokers may be unscrupulous. This booklet is intended to help the borrowing public avoid some of the problems that can arise when dealing with unscrupulous brokers.

The complete text of the Indiana Loan Broker Act is available online at www.IndianaInvestmentWatch.com. It can be found in the section titled "Securities, Laws, Statements, and Regulations."

The Indiana Loan Broker Act does not apply to some loan brokers. If a loan broker is excluded from the Act's coverage, the office has no jurisdiction over him/her. Other loan brokers are exempt from the Act, meaning that they are not subject to the Act's licensing, bonding, and educational provisions but are subject to its antifraud provisions. These provisions forbid the solicitation or collection of a loan broker fee if the loan does not close.

This latter group of exempt loan brokers includes real estate agents and brokers, stockbrokers, investment advisors, and certified public accountants. Usually, an exempt loan broker makes the initial contact with a borrower when providing nonmortgage services to a borrower through the practice of his primary profession — real estate services, stock brokering, investment advising, and tax accounting. Borrowers should be aware that these professionals, acting as loan brokers, will expect additional compensation aside from the fees that they normally charge for services in their primary profession. Most of them will make a written disclosure to the borrower when they are acting as loan brokers, stating that it is the provision of an additional service and that the borrower will be charged for it.

Note:

The basic borrower protection provided by the Indiana Loan Broker Act states that a borrower is not required to pay a loan broker fee if he/she turns down a loan originated for him/her by a loan broker; however, if third party services have been performed, the borrower will still have to pay the actual price of those services, without any markup, regardless of whether he/she accepts the loan.

Examples of third party services and fees:

- Credit report
- Real estate appraisal
- Title search

UNDERSTANDING THE RELATIONSHIP BETWEEN THE BORROWER AND THE MORTGAGE BROKER

A mortgage broker may provide valuable services to the borrower by assisting him/her in obtaining mortgage financing; however, a loan broker is neither the borrower's agent nor fiduciary and might not offer the best available deal from the borrower's perspective. In some instances, the loan broker may earn a fee from the lender in addition to the fee that the borrower pays at the closing. The most common term for this sort of fee is "yield spread premium." The lender pays this yield spread premium as compensation for a loan broker originating a loan at an interest rate higher than the current market rate (also known as an "over-market interest rate"). The practice of originating an over-market interest rate for a borrower is known as "steering," and it is currently a legal practice. A mortgage loan with a yield spread premium component can reduce or eliminate a borrower's out-of-pocket closing costs, but a loan with that component might also increase a loan broker's fees. The only way for a borrower to know the market interest rate of a loan in his/her geographic area is by shopping around for the best rate. Please refer to the "Useful Web Sites" section of this booklet for Web sites that are helpful when checking out current mortgage rates.

Borrowers should keep in mind that purchasing and financing a home is likely to be the most expensive and longest-term contract into which they will ever enter. Mortgages are credit-based transactions, and the interest rates borrowers are offered will be based primarily on their credit report, credit score, and the value of the property they wish to purchase. Borrowers should always shop around and proceed with caution. A mortgage closing that goes wrong could possibly negatively affect a borrower's credit score for a long period of time.

It is important for the borrower to understand that the loan broker has a service to sell, and it is the borrower's job to be educated and informed. A borrower may even wish to hire an attorney before submitting a loan application. This attorney then can act as the borrower's fiduciary, representing his/her interests.

THE ROLE OF THE MORTGAGE LENDER

The lender, not the mortgage broker, establishes the terms of a loan. Most mortgage brokers do not loan their own funds. The lender funds the mortgage by wiring the funds to the escrow account of the title company the day of the closing, or shortly thereafter.

Under the federal Equal Credit Opportunity Act (ECOA), a lender who turns down a mortgage application is required to give the borrower a written notice stating the reason that the loan application has been refused. Oral statements from a mortgage broker about a closing date or "pre-approval" cannot be enforced. The only legally enforceable document is a written loan commitment from the lender, not the mortgage broker.

Borrower Beware

The loan broker with whom you are working should be willing to name and provide the address of the lender to whom he/she has submitted your loan package for underwriting (evaluation) within two to three weeks after your complete application has been taken and the real estate appraisal has been performed. If the loan broker cannot do this, it may be in your best interest to take your business elsewhere (even if you have to pay for a new real estate appraisal). The broker's refusal to identify the lender considering your application may mean the following:

- The broker cannot find a lender due to your credit or other reasons.
- You may be attempting to borrow more than the property is worth.

THE PARTIES INVOLVED IN THE MORTGAGE PROCESS

The Borrower

The borrower is you, the consumer. It is essential that the borrower know the basics of a real estate closing before the closing date. If a borrower tries to learn the mortgage industry vocabulary at the closing table, it will be too late. Many lenders and loan brokers today will accept an application via the Internet. Some will even provide their loan offer via the Internet. At the end of this booklet, there is a list of Web sites that provide basic information. This is information that the borrower will need in order to understand what should happen at a real estate mortgage closing, what written disclosure documents to which he/she is entitled, when he/she is entitled to those documents, and what his/her rights are at the real estate closing.

The Mortgage Broker

The mortgage broker is the "middleman" that brings together a lender and a prospective borrower for a fee. The mortgage broker is neither a fiduciary nor an agent for the borrower. Sometimes, the mortgage broker receives two fees for a successful real estate closing: one fee from the borrower (at the closing) and a second fee from the lender (paid outside of the closing). The mortgage broker is required by the Indiana Loan Broker Act to give the borrower a written "Loan Broker Services Contract" (also known as a "Retention Agreement") that lists the following:

- The dollar amount of the proposed mortgage
- The mortgage broker fee, expressed as a percentage of the mortgage
- The time period during which the borrower must work with the mortgage broker exclusively

The mortgage broker, or the lender, is required to give the borrower a written "Good Faith Estimate of Closing Costs" (GFE) within three business days of taking the mortgage loan application.

Borrower Beware
Mortgage broker fee rates are unregulated by the Act or any other state law. Market forces are said to hold down mortgage broker rates, but if the borrower is considered a riskier loan (based on credit report and credit score), he/she may face a mortgage broker fee anywhere from one to 10 percent of the mortgage loan amount.

The Lender

The lender is the party who funds the borrower's loan. The lender ultimately controls whether the real estate closing happens; lenders also control when the closing occurs. Most mortgage brokers submit the borrower's loan package to several of their lenders. Then the lender, not the mortgage broker, decides whether to fund the borrower's loan. This decision is generally based on a credit risk analysis of the borrower's underwriting package, which has been submitted to the lender by the mortgage broker on the borrower's behalf.

ISSUES BORROWERS ENCOUNTER WITH LOAN BROKERS DURING THE MORTGAGE LENDING PROCESS

Shifting the Closing Date

The borrower's mortgage closing date can shift if he/she does not have a written commitment letter from the lender. It is important for borrowers to remember that if they quit paying the existing mortgage based on an oral promise that the new loan will be closing quickly, borrowers may unknowingly default, causing the former lender to foreclose because he/she has not received the pay-off funds from the new lender in a timely manner.

If the borrower relies on oral promises and quits paying on the old mortgage before the closing of the new mortgage, problems can arise. If the closing goes bad and is not funded, the borrower may find his/her credit damaged without recourse.

Note:
A borrower should not stop paying his/her old mortgage until the new mortgage has officially closed, regardless of any oral promises from the loan broker.

Offer for a "Free" Refinance

Sometimes a mortgage broker will promise to do a "free" refinance of an individual's mortgage in the event that mortgage interest rates drop further from the borrower's present mortgage interest rate. A borrower should realize that every real estate closing has costs; therefore, while a mortgage broker may agree not to charge a fee, other closing costs may still arise.

If such an offer is made, the borrower should get the offer in writing, signed and dated, with the signature of the principal of the loan broker business.

Total Reliance on the Loan Broker

The borrower must always remember that the lender and the loan broker play different roles in the mortgage transaction. They are usually different, unrelated business entities. The borrower should know who the lender is and receive a copy of the "locked loan rate commitment" from the lender in writing on the lender's letterhead.

"Pre-approved" and "Pre-qualified"

The terms "pre-approved" and "pre-qualified" are not legally defined terms and have no value to the borrower. These are marketing terms used by the loan broker to keep the borrower's business. The loan broker may even provide the borrower with a certificate stating he/she is pre-approved or pre-qualified for a mortgage; these certificates are legally meaningless. The only legally binding mortgage loan commitment must be in writing from the lender and must contain specific terms, such as the mortgage loan dollar amount, the mortgage interest rate, and the date the mortgage loan commitment expires (usually no more than 60 days from the date of issuance).

Offer for a "Free" Real Estate Appraisal

A broker may offer a "free" real estate appraisal under the condition that the borrower closes on a mortgage loan through his/her company. This is an acceptable marketing practice used by loan brokers. However, borrowers should be prepared to pay for the appraisal should they decide to take their loan business elsewhere.

The borrower should also remember to get the offer for a free real estate appraisal in writing, with an explanation of any restrictions (such as closing the loan with that particular loan broker).

Falsified Income

An unscrupulous loan broker may encourage the borrower to falsify his/her income on the mortgage application (the "Fannie Mae 1003 Form"). This is fraud. An individual should never present false information. If the borrower cannot document the source of income being reported, he/she is probably trying to buy a property that is not within a reasonable budget. Borrowers should always think realistically when shopping for property.

Loan Flipping

Loan flipping occurs when an unscrupulous loan broker tries to convince a borrower to refinance repeatedly over a short period of time, even if mortgage interest rates have only dropped slightly. All of the closing costs are then included in the total amount borrowed. The loan broker receives a new commission and additional fees for closing each new loan.

This action can result in "equity stripping." The borrower is convinced to tap into his/her home equity repeatedly as a "cash-out refinance" to pay for other debt (e.g., credit card expenses or medical bills), causing him/her to repeatedly take on more mortgage debt. Upon each refinance, the equity that the borrower has in his/her home continues to decrease.

Over-Appraised Residential Real Estate

This occurs when an unscrupulous loan broker, real estate appraiser, and/or real estate agent collude to get a marginal property appraised at a value grossly above its market value. Such unscrupulous advisers may attempt to coax borrowers into participating by telling them that they can borrow more mortgage money, put no payment down, and "come out ahead" by falsifying their income on the mortgage application.

In these instances, if the borrower defaults, the loan is foreclosed, and the lender discovers the falsified appraisal, the lender can pursue the real estate appraiser, real estate agent, loan broker, and the borrower for fraud.

Undisclosed Pre-payment Penalties, Balloon Payments, and Rate and Terms Switched at Closing

The following kinds of loan clauses do not, as a general rule, have to be disclosed to the borrower in writing prior to closing. It is also not required that they be called to the borrower's attention at closing. It is up to the borrower to ask questions. If the borrower does not ask, he/she may end up with a completely different loan, rate, or terms than what was orally promised.

The borrower is legally entitled to copies of all the documents that he/she signs at the closing. These documents include the mortgage, the promissory note, and the various disclosure forms.

Pre-payment Penalties

Under Indiana law, pre-payment penalties are allowed on second mortgages. Any borrower pursuing a second mortgage should be sure to ask ahead of time about pre-payment options. Some sub-prime first mortgages also contain pre-payment penalties.

Balloon Payments

A balloon payment occurs when the borrower makes low, interest-only monthly payments. The principal is then due in one lump sum at the end of the loan.

Rates and Terms Switched at Closing

The loan documents presented at closing should reflect the type of loan and terms promised to the borrower. A borrower should be sure to find out where the title company is located and who the title clerk is before the closing. He/she should contact the title clerk one business day before the closing for the draft of the HUD-1 Settlement Statement. Borrowers are entitled to this statement under the Real Estate Settlement and Procedures Act (RESPA). Borrowers should look closely at this statement, watching for any fees or costs that he/she does not understand. If there are any of note, the borrower should question them and remember that closing costs are a matter of negotiation.

The Post-Closing Squeeze for More Fees

RESPA requires that the HUD-1 Settlement Statement list all fees paid at the closing table or paid outside of closing (P.O.C.). These fees must be fully disclosed as to the dollar amount and to whom the fee was paid. Any party that calls the borrower after the closing and tries to collect additional undisclosed fees from the borrower is acting illegally. If such an attempt occurs, the borrower should contact the lender and the title company. The borrower should also contact the Secretary of State's office at 800.223.8791 to report such attempts.

CHECKLIST FOR USING THE SERVICES OF A LOAN BROKER

When using the services of a loan broker, the borrower can benefit by considering the answers to the following questions:

- ❒ Have I checked the status of the loan broker with the Indiana Secretary of State's Securities Division? Do I know whether he/she is licensed, exempt, or unregistered? Call **800.223.8791** or visit the Secretary of State on the Web at **www.IndianaInvestmentWatch.com.**

- ❒ Have I reviewed my credit report and checked my credit score so that I am prepared to borrow a realistic amount of mortgage money? Do I know whether I am a sub-prime borrower?

- ❒ Have I made copies of all documents I have provided to the loan broker? (Having copies of all documents will assure the documents are available should you decide to take your business elsewhere.)

- ❒ Do I have the completed and signed Loan Broker Service Contract? (This contract should state the proposed borrow amount as well as the broker's fees in the event that the loan closes.)

- ❒ Did I receive a complete Good Faith Estimate of Closing Costs that also addresses yield spread premium?

- ❒ Has the loan broker given me a copy of my application, plus other documents, as I sign them?

- ❒ Have I been informed within two to three weeks of my completed application of the name of the proposed lender, the lender's business address and telephone number, the method of funding, and when I will receive the written loan commitment letter from the lender?

- ❒ Do I know if the loan will contain a pre-payment penalty, balloon payment, and escrow account for taxes?

- ❒ Do I know where the closing will take place and how to contact the title company conducting the closing?

- ❒ Have I been provided with a draft copy of the HUD-1 Settlement Statement one business day prior to the closing? Have I compared the fees with the Good Faith Estimate of Closing Costs?

- ❒ Am I prepared to leave the closing if I find that the fees and the terms do not match what I was promised?

- ❒ Did I receive complete copies of the mortgage, the promissory note, and all other closing documents?

- ❒ Does the lender "service" (collect monthly payment) for his/her own mortgages, or will the servicing be sold? (If the servicing is sold after closing, the lender is required by federal law to give the telephone number, business address, and name of the mortgage service company in writing.)

USEFUL WEB SITES

HSH Associates, Financial Publishers

www.hshassociates.com

Source for current mortgage rates for all types of mortgages, including a mortgage calculator.

Bankrate.com

www.bankrate.com

Search for current mortgage rates and fees for a specific geographic area.

Mortgage Professor

www.mtgprofessor.com

Defines mortgage terms and gives practical advice on types of mortgages, closing costs, loan brokers, and strategies to get the best mortgage. Written by Jack Guttentag, a retired finance professor from the Wharton School of Business at the University of Pennsylvania, this Web site has many useful spreadsheets to use for calculating various "what if" scenarios.

Department of Housing and Urban Development (HUD)

www.hud.gov/offices/hsg/sfh/res/sfhrestc.cfm

This part of the HUD Web site offers brochures about mortgage escrow servicing complaints and explains what written disclosures loan brokers must make to borrowers under federal law. It also explains legal remedies provided by the Real Estate Settlement Procedures Act (RESPA). Articles are also available in Spanish.

Federal Reserve Board

www.federalreserve.gov/consumers.htm

This Web site offers various tips for borrowers, including a section with valuable information about mortgages. The brochure entitled "Looking for the Best Mortgage" contains a mortgage interest rate shopping worksheet and explains the Equal Credit Opportunity Act (ECOA). It also explains the requirement for a written mortgage denial from the lender.

AARP

www.aarp.org/revmort

This section of the AARP Web site has information on reverse mortgages (also known as Home Equity Conversion Mortgage or HECM), explaining how they work, complete with calculator spreadsheets to assist the borrower.

Federal Trade Commission

www.ftc.gov/bcp/menu-credit.htm

This is a direct link to articles that explain credit scoring and how to dispute errors in your credit report.

Credit Reports and Credit Scores

www.experian.com
www.transunion.com
www.equifax.com

Experian, TransUnion Corp., and Equifax are the three major credit reporting agencies. Each of these agencies should be contacted, as borrowers should check all three reports for accuracy.

GLOSSARY OF MORTGAGE TERMS

Appraisal – The sale value of a property based on analysis by a licensed real estate appraiser. The analysis is based on the condition of the property and the value of comparable properties.

Bona Fide Third Party Fees – Fees imposed by the loan broker to cover costs incurred by a third party. The three most common types of these fees are for the title search, appraisal, and credit report.

Cash-out Refinance – Refinancing the original mortgage in order for the homeowner to obtain money for additional expenses.

Credit Score – Numerical value based upon credit history. Commonly referred to as FICO score.

Credit Report – A report on the past ability of a loan applicant to pay installment payments. Several national and local companies make such reports.

ECOA – Equal Credit Opportunity Act. The Equal Credit Opportunity Act (ECOA) ensures that all consumers are given an equal chance to obtain credit.

Escrow Account – Account established by the lender that is commonly used to pay property tax and insurance. A part of the borrower's mortgage payment is deposited into this account.

Exempt Loan Brokers – Loan brokers that fall under the jurisdiction of the Indiana Loan Broker Act but are not subject to its registration and education requirements.

Fannie Mae 1003 Form – Uniform Residential Loan Application.

First Mortgage – A mortgage having the first priority in the event of default.

FICO – See credit score.

GFE – Good Faith Estimate of Closing Costs. The GFE is required under RESPA to be given within three days of the mortgage application submission.

HUD-1 Settlement Statement – Required under RESPA, this statement should be provided to the borrower at the closing. The statement lists all of the costs of the deal, for both the borrower and the lender.

Mortgage Broker – The institution that finds a lender for a fee. In other words, the "middleman" between the lender and the borrower.

Mortgage Lender – The institution that funds a mortgage loan.

P.O.C. – Paid outside of closing.

Promissory Note – A contractual agreement between the lender and the borrower. Also known as the mortgage note, this is the signed document that defines the terms of the loan.

RESPA – Real Estate Settlement and Procedures Act. RESPA requires that consumers receive disclosures at various times in the transaction and outlaws kickbacks that increase the cost of settlement services. RESPA is enforced by the Department of Housing and Urban Development (HUD).

Second Mortgage – A mortgage which ranks after a first mortgage in priority. Typically, the value of the second mortgage is less than that of the first mortgage. A second mortgage is not the same as a refinance. Properties may have two, three, or more mortgages at one time.

Title Company – Company that searches the title of the property for liens or judgments, facilitates the property closing, and records the new title and promissory note.

Underwriting – Process of evaluating a loan application and property in order to determine whether or not to make a loan.

Yield Spread Premium/YSP – A fee paid by the lender to the loan broker in addition to the fee that the borrower pays at the closing. This fee is paid as compensation for originating a higher interest rate loan (over-market interest rate) for a borrower. Any yield spread premium that is to be paid by the lender to the mortgage broker is listed on the HUD-1 Settlement Statement, and will be marked "P.O.C." If yield spread premium is to be paid, it will be noted on the GFE. It is usually listed as an acronym, such as "YSP, 0–3%."

The Honorable Todd Rokita
Indiana Secretary of State

The Office of the Indiana Secretary of State

Securities Division

O. Wayne Davis
Securities Commissioner

Stephanie L. Beck
Investor Education Coordinator

Kellie M. Duke
Director of Investor Education

To request additional copies of this or other materials, please contact:

Indiana Secretary of State Todd Rokita
Investor Education Program
302 West Washington Street
Room E-111
Indianapolis, Indiana 46204
Phone 317.232.6681
Toll-free 800.223.8791
Fax 317.233.3675
www.IndianaInvestmentWatch.com